

**REMARKS**

This Amendment and Request for Reconsideration is submitted with a Request for Continued Examination and is in response to an outstanding Office Action (**Final Rejection**) dated November 24, 2008, the shortened statutory period for response having expired on February 24, 2009. A petition and fee for an extension of time are included. In the event that the Commissioner determines that a further extension of time is required, the undersigned hereby petitions for any such extension of time, and authorizes the Commissioner to charge the Milbank deposit account 13-3250 for any required fee.

I. Status of the Claims

Please amend claims 12, 21, 22, 23, 24, 42, 52, 53, 54, 87, 88 and 89 as indicated above. Claims 1-11, 16, 20, 25-41, 44-45, 51, 58-86, and 90-92 were previously cancelled without prejudice. Claims 12-15, 17-19, 21-24, 42, 43, 46-50, 52-57 and 87-89 are now pending in the application. Pending claims 12, 21, 22, 23, 24, 42, 52, 53, 54 and 87 are independent claims.

II. Rejections under 35 U.S.C. § 103

In the Office Action, the Examiner has rejected the pending claims under 35 U.S.C. § 103(a) as being unpatentable over U.S. Patent No. 6,173,270 to *Cristofich*, what the Examiner characterizes as applicant's admitted prior art (AAPA), a speech by SEC Commissioner Glassman ("*Glassman*"), U.S. Patent No. 6,393,409 to *Young et al.* and U.S. Patent No. 6,098,051 to *Lupien*. The Examiner states:

The stock exchanges are regulated by government agencies and also by the rules of each exchange. As such, the brokers serving buyers and sellers of publicly traded shares have a fiduciary responsibility to always obtain the best available price for the customer for buy and sell orders. There are detailed guidelines for the execution of this responsibility. Also, Applicant's specification

defines at least some embodiments of the invention which involve a customer's specifying 'automatic execution' of an order as related to a customer's limit order (specification, p. 20, ll 7- p.21, l 3). In this embodiment, the transaction executes in the same manner as a limit order without Applicant's 'indication' through an 'NX' designation for the transaction prior to Applicant's invention. The price of the limit order would be the same with or without Applicant's invention. If the specialist has offers in hand which are equal to or better than the customer's limit price and if the other parameters of the customer's order are satisfied in all respects the order would execute without going to the floor. Applicant's designation by the customer of 'automatic execution' of the order in the claimed limitations and as supported by the specification would be a convenience which has not substantive role in the process or method. In other words, an automatic indication symbol such as 'NX' is non-functional descriptive material in the context of patentability. The indication and the indicator symbol may well be a convenience with positive marketing appeal, but it does not receive patentable weight.

Applicants respectfully disagree that designating an order for automatic execution as recited in the claims, whether the designation is through an "NX" symbol or in some other manner is non-functional. In particular, this statement by the Examiner is not correct as NYSE operated prior to the instant invention: "If the specialist has offers in hand which are equal to or better than the customer's limit price and if the other parameters of the customer's order are satisfied in all respects the order would execute without going to the floor"

Claim 12 recites in part: automatically determining whether the securities order includes an indicator requesting automatic execution;

exposing the order to an auction market of the single securities exchange for possible price improvement if the securities order does not include an indicator requesting automatic execution;

automatically executing at least a portion of the order at a quote price, without exposing the order for possible price improvement, if the securities order includes an indicator

requesting automatic execution;

Thus, according to the claim, if the securities order does not include an indicator requesting automatic execution, the order is exposed to an auction market of the single securities exchange for possible price improvement. Alternatively, if the securities order includes an indicator requesting automatic execution, at least a portion of the order is automatically executed at a quote price. According to the Examiner's comments in the Office Action, those two alternatives render an identical result, and therefore the designation for automatic execution is non-functional. That is incorrect because with exposure for possible price improvement the execution price may be different than the quote price. The following example will illustrate. Assume the published market quote for the security is 1000 shares bid to buy at \$31.11 and 800 shares offered to sell at \$31.14. Because the number of shares or the size is represented in increments of 100 share round lots, that published quote is illustrated as:

31.11	31.14
10	8

At NYSE before the instant invention, round lot orders were exposed to the auction market for possible price improvement. Exposure of orders to the auction market for possible price improvement applied to round lots of limit orders and market orders. Exposing an order for possible price improvement meant that any brokers gathered at the post for the listed security would have an opportunity to take a more aggressive price position than the price position represented by the published quote. So, before the instant invention and with the market quote as illustrated above, if a limit order arrived to buy 600 shares priced at \$31.14, the specialist for the security was not allowed to immediately execute that incoming 600 share limit

order at \$31.14, even though the quote showed that there were 800 shares offered for sale at the same \$31.14 price. Instead, the specialist was required to first expose the limit order to the auction market for possible price improvement. In this example, when the limit order to buy 600 shares at \$31.14 was exposed for possible price improvement, a trader in the crowd might decide to sell 600 shares at \$31.13. Under that circumstance, the 600 share buy order would get price improvement of \$0.01. The limit buy order would execute at \$31.13, not at the quoted offer to sell price of \$31.14.

Before the instant invention, market orders were handled in a similar way. So, for example with the quote as illustrated above, if a market order to buy 600 shares arrived, the specialist was required to expose the market order to the auction market for possible price improvement. With the quote as indicate above, if a market order to buy 600 shares arrived and it was exposed for possible price improvement, another broker might have decided to sell 600 shares at \$31.13, and the market order to buy would similarly get \$0.01 of price improvement. Thus, before the instant invention, limit and market orders in round lot sizes were exposed to the auction market for possible price improvement. Exposure for possible price improvement did not mean that an order got price improvement, but round lot orders were exposed to the auction market for possible price improvement.

The NYSE rules regarding order exposure to the auction market for possible price improvement changed on January 4, 2001 when the SEC approved NYSE's proposed Rule Change to implement NYSe Direct+. The claims of the instant patent application are directed to features of NYSe Direct + as described in that proposed rule change. The initial proposed rule change was published on June 15, 2000 in the Federal Register at 65 FR 37587. The authorization for the rule change was published on January 4, 2001 in the Federal Register at 66

FR 834. Copies of 65 FR 37587 and 66 FR 834 are enclosed. Under the proposed new rule, automatic execution (“auto ex”) for certain types of limit orders was available. As stated in 65 FR 37587 and 66 FR 834, auto ex orders would receive an automatic execution without being exposed to the auction market.

Under the new rule, and as recited in claim 12, at least a portion of the order is automatically executed at a quote price, without exposing the order for possible price improvement, if the order includes an indicator requesting automatic execution.

So, with the same market quote from the example above:

31.11	31.14
10	8

under the new rule, if a limit order identified for automatic execution arrived to buy 600 shares priced at \$31.14, the specialist for the security immediately executed that incoming 600 share limit order at the quoted offer of \$31.14. So, with the same level of possible price improvement available in the auction market, the two alternatives recited in claim 12 would render different results depending on whether the incoming order is designated for automatic execution:

Limit order to buy <b>not</b> designated for automatic execution	Limit order to buy designated for automatic execution
<b>Order exposed</b> for possible price improvement Price improvement of \$0.01 provided	<b>Automatic execution</b> at the quote price <b>without exposing</b> for possible price improvement
Execution price <b>\$31.13</b>	Execution price <b>\$31.14</b>

The claimed designation for automatic execution is a functional element and may

produce a different execution price depending on whether the automatic execution designation is present or absent.

*Hasbrouck*, which is a reference that was relied on by the Examiner in an earlier office action, specifically describes the situation requiring exposure for price improvement prior to the instant invention, stating (emphasis added): “Because the NYSE specialist must expose market orders to the crowd and does not automatically execute them against the posted quote, ‘price improvement’ is possible: market orders may be executed at better than the quoted price and limit orders may be executed at better than the limit price.” *Hasbrouck*, page 13, last paragraph.

Turning to the references cited in the current rejections. One particular section of *Cristofich* that is relied on by the Examiner (col. 9, lines 15-20) states: “The system then accesses the current quote ... accessed the current quote for the specified security, ... and compares this price data ... If the comparison criteria is met, ... the system links to an exchange for automatic execution of the options exercised.” *Cristofich* does not say how the automatic execution is performed, only that the system links to an exchange for automatic execution. Thus, any automatic execution described in *Cristofich* is limited to “automatic execution” of the options as available on exchanges existing in 1997 or possibly earlier.

For options exchanges, Applicants know there were floor-based options exchanges in 1997, such as the Chicago Board Options Exchange (“CBOE”). Applicants also know that the International Securities Exchange (“ISE”) is a non-floor-based “automated” options exchange, and that ISE began trading operations in mid-2000. Applicants also know that at some time after mid-2000, CBOE developed a hybrid system that offered both traditional floor-based trading and “automated” trading. However, prior to the beginning of trading

operations by ISE in mid-2000, Applicants are not aware of any “automated” options exchanges in the prior art, or in particular, any options exchanges where orders were executed during regular trading hours without exposure to a floor-based trading crowd. Thus, the statement relied on in *Cristofich* regarding “automatic execution of the options exercised” does not support an “automatic” execution in the sense that an automatic execution is done without exposure to a trading crowd for possible price improvement, because there is no evidence that such an “automatic” execution for options as described in *Cristofich* was even possible in 1997.

At most, *Cristofich* discloses making a comparison to a quote price for a security and if the comparison is favorable, then sending an order to an options exchange for execution. Although *Cristofich* describes that as an “automatic execution” there is no evidence to show that the described “automatic execution” was done without exposing the order on the trading floor of the existing floor-based options exchanges for possible price improvement, because there is no evidence that any of the existing options exchanges offered such an automatic execution feature. In fact, automatic execution without exposing for possible price improvement on the options trading floor may have violated a fiduciary duty to obtain the best price, which the Examiner relies heavily on in the rejection. Further, there is absolutely nothing in *Cristofich* that shows a split path for execution, where one path is exposing the order for possible price improvement if the securities order does not include an indicator requesting automatic execution, and the other path is automatically executing at least a portion of the order at a quote price, without exposing the order for possible price improvement, if the securities order includes an indicator requesting automatic execution.

There is also nothing in *Cristofich* that discloses or suggests an execution allocation option, where the option is selected from the group of crowd only, book only, or

percentage to crowd and percentage to book. This is because *Cristofich* discloses nothing about the actual execution, or post-execution process. *Cristofich* says merely “the system links to an exchange for automatic execution of the options exercised.”

Further, *Cristofich* says nothing about the claimed order for the steps, where the execution allocation option is assigned before a securities order is received, then after the order is executed, the order is automatically allocated among contra parties according to the assigned execution allocation option. This particular ordering is important to the invention because it allows the allocation option to be pre-set before orders are received. Being pre-set means no input is required as to the assigned execution allocation option once an order is received -- there is no need to slow the execution process down to assign an allocation option, since it is already assigned. Further, by making the execution step before the later allocation step, the order can be executed immediately and the system does not even need to determine which contra parties will participate or receive an allocation. That determination can follow the execution. These differences are in marked contrast to a traditional floor-based open-outcry auction, where there was no pre-set execution allocation option that was one of the three indicated options.

In addition, there is nothing in *Cristofich* that discloses or suggests many of the other elements of the pending claims. For claim 12 in particular, *Cristofich* does not disclose or suggest the following features:

assigning an execution allocation option to a security, wherein the execution allocation option is one of three options selected from the group consisting of allocate execution to crowd only, allocate execution to book only, or allocate a percentage of execution to crowd and allocate a percentage of execution to book;

automatically determining whether the securities order includes an indicator

requesting automatic execution;

exposing the order to an auction market of the single securities exchange for possible price improvement if the securities order does not include an indicator requesting automatic execution;

automatically executing at least a portion of the order at a quote price, without exposing the order for possible price improvement, if the securities order includes an indicator requesting automatic execution;

automatically determining the assigned execution allocation option; and  
after automatically executing at least a portion of the order, automatically allocating shares of the automatic execution among contra parties according to the assigned execution allocation option.

The other independent claims (21, 22, 23, 24, 42, 52, 53, 54 and 87) recite similar features that are not found in *Cristofich*.

With respect to what the Examiner characterizes as AAPA, applicants respectfully disagree. In particular, the Examiner relies on statements in the Background. In 2000, without the instant invention, there was not much flexibility available to investors for execution. Almost without exception, securities traded exclusively on the listing exchange. That meant an NYSE listed security was almost exclusively traded at NYSE in open-outcry and necessarily all orders were presented to the auction crowd for possible price improvement. Alternatively, a NASDAQ listed security was almost exclusively traded on NASDAQ and was not traded in open-outcry. Executions at NASDAQ were against the posted bid/offer, without exposure for possible price improvement. Prior to the instant inventions, there was almost no ability for an investor, who wanted to trade round-lots of an NYSE listed security, to take advantage of trading at the posted

bid/offer without price improvement, such as found at NASDAQ. Alternatively, an investor who wanted to trade a NASDAQ listed security had almost no ability to get price improvement over the published bid/offer. That is what the statements in the background of the specification are referring to. Instead of the instant invention, a solution to those issues might have been to allow investors to trade securities on other exchanges. That would have allowed NYSE listed securities to trade on NASDAQ, offering execution against the published bid/offer, without price improvement. However, in 2000 when the priority application for this invention was filed, securities were almost exclusively traded on the listing exchange. Thus, the instant invention is not an obvious result of the issues identified in the Background.

Applicants do acknowledge that in the prior art there were open-outcry exchanges, such as NYSE, and there were electronic exchanges, such as NASDAQ. However, both exchanges had been in existence for a number of years, and until the instant invention, there was no system that offered for a single security at a single exchange, both automatic execution without price improvement, and exposure for possible price improvement, where there was an ability to select the particular desired type of execution.

With respect to Commissioner Glassman's speech, the Examiner appears to rely on the speech for the proposition that broker-dealers owe a fiduciary duty to customers, and a duty to put the customer's interests first. If that were strictly the case, then at NYSE, where price improvement is available in open-outcry, the only appropriate execution would be exposure of all orders for possible price improvement. An execution performed without such exposure for price improvement would be a violation of the broker/dealer's fiduciary duty. Exposure for price improvement is precisely what NYSE offered prior to the instant invention, and execution without price improvement is one of the alternative features offered by the claims in the instant

inventions. Thus, the speech by Commissioner Glassman actually teaches away from the instant inventions because under the instant inventions, execution at a bid/offer price without exposure for price improvement is offered. If a better price would be available in open-outcry, then the instant inventions would be contrary to the fiduciary duty described in *Glassman*. Accordingly, a person of ordinary skill, considering the fiduciary duty described in *Glassman*, would not be motivated to consider a system that does not strictly provide the best possible execution price. Applicants submit that all of the claims are allowable over the cited art for the stated reasons.

There are further features in the claims that are not disclosed in the cited references. In particular, the assigned execution allocation option is assigned before the securities order is received, and is one of three possible options: allocate execution all to crowd; allocate execution all to book; or allocate a percentage of execution to crowd and a percentage of execution to book. There is nothing in any of the cited references that discloses or suggests such an execution allocation option, those three particular allocation options, or the claimed order of assigning the allocation option before receiving the securities order. Applicants respectfully submit that all of the claims are further allowable over the cited references for these additional reasons.

The arguments above generally apply to all of the independent claims. With respect to independent claim 54, in addition to the numerous distinguishing features explained above, the claim further recites:

comparing the size of the order to a respective interest in the security if the securities order includes an indicator requesting automatic execution;

changing the status of at least a portion of the order from automatic execution to regular execution if the securities order includes an indicator requesting automatic execution and

the size of the order is greater than the interest.

The Examiner does not point to any particular disclosure in *Cristofich*, *AAPA*, *Glassman*, *Young* or *Lupien* for those features, but instead states “[i]t would have been obvious to change the status of an order from automatic execution to regular execution if the respective interest in the security does not meet the size of the security being offered, since no exact matching counter party offer is available for automatic execution. ... The ordinary practitioner would have seen it as obvious that the order had to be changed from automatic to regular execution.”

Applicants respectfully submit that claim 54 does not change the entire order from automatic to regular execution. Instead, the claim language states “changing the status of at least a portion of the order...” Then, the claim goes on to automatically execute at least a portion of the order. If the entire order were changed to regular execution, there would be nothing left for automatic execution. Thus, contrary to the Examiner’s unsupported argument, the entire order is not changed from automatic to regular execution. Instead, a portion of the order is changed to regular execution, and a portion of the order is automatically executed. There is nothing obvious about doing that.

Motivation to combine references. For every one of the rejections, the Examiner’s stated motivation is: “a desire to provide a data processing method and system for managing individual accounts directed to the transacting of securities transactions with pre-established criteria.” The Examiner points to *Cristofich* (col. 2, lines 29-33) as support.

Respectfully, that stated motivation bears absolutely no relevance to the pending claims or anything else of relevance to the instant inventions. The stated motivation is meaningless as a motivation for implementing any change or combining any of the cited

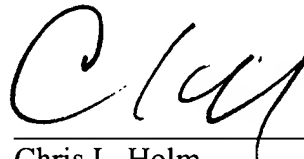
references. The stated motivation to combine is unsupported, it is improper, and it is simply a part of a sentence that the Examiner has extracted and modified from *Cristofich* in an effort to justify the hind-sight reconstruction of the claims from multiple pieces of prior art that individually and in combination fail to show all of the elements of the claims.

In the current and in prior Office Actions and in this and prior responses to those Office Actions, the undersigned has addressed a number of issues, but not every issue raised by the Examiner. The undersigned has focused on significant areas of distinction between the cited references and the pending claims. The undersigned's decision in this response to respond only to the significant issues instead of every point presented by the Examiner is not an admission that the Examiner is correct on those issues.

III. Request for Reconsideration

Applicants respectfully submit that the claims of this application are in condition for allowance. Accordingly, reconsideration of the rejection and allowance is requested. If a conference would assist in placing this application in better condition for allowance, the undersigned would appreciate a telephone call at the number indicated.

Respectfully submitted,  
Milbank, Tweed, Hadley & McCloy LLP



Chris L. Holm  
Reg. No.: 39,227

April 20, 2009

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position itself to ensure continued service enhancements and the achievement of various business initiatives without deterioration of its capital base. GSCC's costs to develop, implement, and support these new services will be considerable. For example, real-time messaging will involve extensive systems development as well as the costs associated with maintaining multiple input environments. Moreover, many of these services, such as the shift to real-time comparison and risk management, will, in and of themselves, not generate any additional revenues for GSCC.

Assuming that current net income levels are sustained, it is GSCC's intention to reinstate a discount methodology as a business incentive for members to move to real-time messaging. The reinstated discount would be applied to both buy-sell and repo transactions; currently, the discount lowers fees only for buy-sell transactions, which creates inequities in the manner in which it applies to members.

GSCC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to GSCC and in particular with Section 17A(b)(3)(F) of the Act because it will permit GSCC to cover the high costs involved in providing its members with new and important services.

*(B) Self-Regulatory Organization's Statement on Burden on Competition*

GSCC does not believe that the proposed rule change will have an impact or impose a burden on competition.

*(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

Written comments relating to the proposed rule change have not yet been solicited or received. Members will be notified of the rule change filing, and comments will be solicited, by an Important Notice. GSCC will notify the Commission of any written comments received by GSCC.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Act**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii)<sup>3</sup> of the Act and Rule 19b 4(f)(2)<sup>4</sup> promulgated thereunder because the proposal establishes or

changes a due, fee, or other charge imposed by GSCC. At any time within sixty days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549 0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of GSCC. All submission should refer to File No. SR GSCC 00 06 and should be submitted by June 6, 2000.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

Margaret H. McFarland,  
Deputy Secretary.

[FR Doc. 00 15088 Filed 6 14 00; 8:45 am]

BILLING CODE 8010-01-M

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-42913; File No. SR-NYSE-00-18]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the New York Stock Exchange, Inc. Relating to NYSe Direct+, the Exchange's Automatic Execution Facility for Certain Limit Orders of 1099 Shares or Less**

June 8, 2000.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

("Act"),<sup>1</sup> and Rule 19b 4 thereunder,<sup>2</sup> notice is hereby given that on May 1, 2000, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The proposed rule change consists of new Exchange Rules 1000 through 1005 governing trading through NYSe Direct+™, a new Exchange facility to provide automatic execution of limit orders of a specified size. The proposed rule change also amends Exchange Rule 13 to define an "auto ex" order and Exchange Rule 476A to include proposed Rules 1000 through 1005 in the list of rules subject to summary fine procedures. The Exchange is also submitting for Commission approval interpretations of Exchange Rules 104, 123A.40, and 91, and it will request separately that the Commission issue the appropriate relief from Commission Rule 10a 1.<sup>3</sup> The text of the proposed rule change is set forth below. All language is being added.

**Rule 1000: Automatic Execution of Limit Orders Against Orders Reflected in NYSE Published Quotation**

Only straight limit orders without tick restrictions are eligible for entry as auto ex orders. Auto ex orders to buy shall be priced at or above the price of the published NYSE offer. Auto ex orders to sell shall be priced at or below the price of the NYSE bid. An auto ex order shall receive an immediate, automatic execution against orders reflected in the Exchange's published quotation and shall be immediately reported as NYSE transactions, unless:

(i) The NYSE's published quotation is in the non-firm quote mode;

(ii) The NYSE's published quotation has been gapped for a brief period because of an influx of orders on one side of the market, and the NYSE's published quotation size is one hundred shares at the bid and/or offer;

(iii) With respect to a single-sided auto ex order, a better price exists in another ITS participating market center;

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b 4.

<sup>3</sup> 17 CFR 240.10a 1.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>4</sup> 17 CFR 240.19b 4(f)(2).

<sup>5</sup> 17 CFR 200.30 39A(12).

(iv) With respect to a single-sided auto ex order, the NYSE's published bid or offer is 100 shares;

(v) A transaction outside the NYSE's published bid or offer pursuant to Rule 127 is in the process of being completed, in which case the specialist should publish a 100-share bid and/or offer;

(vi) Trading in the subject security has been halted.

Auto ex orders that cannot be immediately executed shall be displayed as limit orders in the auction market.

#### Rule 1001: Execution of Auto Ex Orders

(a) Subject to Rule 1000, auto ex orders shall be executed automatically and immediately reported. The contra side of the execution shall be orders reflected in the Exchange's published quotation, as follows:

(i) The first contra side bid or offer at a particular price shall be entitled to time priority, but after a trade clears the Floor, all bids and offers at such price shall be on parity with each other;

(ii) All bids or offers on parity shall receive a split of executions in accordance with Rule 72;

(iii) The specialist shall be responsible for assigning the number of shares to each contra side bidder and offeror, as appropriate, in accordance with Rule 72, with respect to each automatic execution of an auto ex order;

(iv) The specialist shall be the contra party to any automatic execution of an auto ex order where interest reflected in the published quotation against which the auto ex order was executed is no longer available;

(v) A universal contra shall be reported as the contra to each automatic execution of an auto ex order.

(b) If the depth of the published bid or offer is not sufficient to fill an auto ex order in its entirety, the unfilled balance of the order shall be routed to the Floor and shall be displayed in the auction market.

(c) If at any time automatic executions of auto ex orders result in the execution of all trading interest reflected in the Exchange's published quotation at the bid or offer price, the Exchange shall disseminate a bid or offer at that price of 100 shares until the specialist re-quotes the market. Auto ex orders shall not be automatically executed against any 100 share bid or offer, whether a default bid or offer or otherwise, but shall be routed to the Floor and shall be displayed in the auction market. The specialist shall be the contra party to any auction market transaction at such default bid or offer price.

(d) No published bid or offer shall be entitled to claim precedence based on size with respect to executions against auto ex orders.

#### Rule 1002: Availability of Automatic Execution Feature

Orders designed as "auto ex" in a particular stock shall be eligible to receive an automatic execution if entered after the Exchange has disseminated a published bid or order in that stock until 3:59 p.m. or within one minute of any other closing time of the Exchange's floor market. Orders designated as "auto ex" in a particular stock that are entered prior to the dissemination of a bid or offer in that stock, or after 3:59 p.m. or within one minute of any other closing time, shall be displayed as limit orders in the auction market.

#### Rule 1003: Application of Tick Tests

If a transaction is being completed in the auction market, and an automatic execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to such auction market transaction shall be based on the last reported trade prior to such execution of auto ex orders.

#### Rule 1004: Election of Stop Orders and Percentage Orders

Automatic executions of auto ex orders shall elect stop orders and percentage orders electable at the price of such executions. Any stop orders so elected shall be executed pursuant to the Exchange's auction market procedures, and shall not be guaranteed an execution at the same price as subsequent automatic executions of auto ex orders.

#### Rule 1005: Orders May Not be Broken Into Smaller Amounts

Orders of greater than 1099 shares many not be broken up into smaller amounts for the purpose of receiving an automatic execution. An auto ex order for any account in which the same person is directly or indirectly interested may only be entered at intervals of no less than 30 seconds between entry of each such order.

\* \* \* \* \*

#### Rule 13: Definitions of Orders

\* \* \* \* \*

#### Auto Ex Order

An auto ex order is a limit order of 1099 shares or less priced at or above the Exchange's published offer (in the case of an order to buy) or at or below the Exchange's published bid (in the

case of an order to sell), which a member or member organization has entered for automatic execution in accordance with, and to the extent provided, by Exchange Rules 1000 1005.

\* \* \* \* \*

#### List of Exchange Rule Violations and Fines Applicable Thereto Pursuant to Rule 476A

\* \* \* \* \*

- Failure to adhere to procedures for automatic execution of orders under the NYSe Direct+™ facility (Rules 1000 1005)

\* \* \* \* \*

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and bases for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

The purpose of the proposed rule change is to provide for the automatic execution of limit orders of 1099 shares or less ("auto ex" orders) against trading interest reflected in the Exchange's published quotation. It would not be mandatory that all limit orders of 1099 shares be entered as auto ex orders; rather, the member organization entering the order, or its customer if enable by the member organization, can choose to enter an auto ex order when such member organization (or customer) believes that the speed and certainty of an execution at the Exchange's published bid or offer price is in its customer's best interest. In such a case, the member organization would enter an auto ex order priced at or above the Exchange's published offer price (in the case of an auto ex order to buy), or an auto ex order priced at or below the Exchange's published bid price (in the case of an auto ex order to sell). The auto ex order would then receive an automatic execution without being exposed to the auction market, provided

the bid or offer is still available.<sup>4</sup> In any instance where, as specified in Rule 1000, the automatic execution feature is not available, the auto ex order will be entered for execution in the Exchange's auction market. Auto ex transactions would be identified on the Consolidated Tape with a unique identifier. The Exchange's published bid or offer would be automatically decremented to the extent of the size of the auto ex order to reflect the automatic execution. The contra side of the auto ex order execution would be the trading interest reflected in the Exchange's bid or offer, with such interest participating in the execution in accordance with the Exchange's auction market principles of priority and parity as codified in Exchange Rule 72.

Any member organization or a customer, if enabled by the member organization, that believed in any particular case that the customer's interests would be best served by affording the customer's order the opportunity for price improvement may enter a limit or market order by means of the SuperDOT system for representation in the auction market, rather than an auto ex order.

The Exchange's proposal would be implemented in a new series of rules, Rules 1000 through 1005 and a proposed amendment to Rule 13. In addition, to facilitate the Exchange's ability to induce compliance with proposed Rules 1000 through 1005, the Exchange is proposing to amend Exchange Rule 476A to include these rules in the list of rules subject to summary fine procedures.

The proposal would be implemented at the outset as a pilot program in a limited number of stocks prior to being made available in all stocks.<sup>5</sup>

#### Rule 13

The Exchange proposes to amend Rule 13 to define the term "auto ex order." An auto ex order is a limit order

of 1099 shares or less priced at or above the Exchange's published offer (in the case of an order to buy) or at or below the Exchange's published bid (in the case of an order to sell) that will receive an automatic execution against the interest reflected in the published quotation, provided the size of the published quotation is greater than 100 shares. An auto ex order or any portion thereof that cannot be immediately executed shall be displayed as a limit order in the Exchange's auction market. The new rules provide as follows:

#### Rule 1000

Rule 1000 states the basic operative principles providing for automatic execution of limit orders of 1099 shares or less against the Exchange's published quotation. The Rule lists six instances in which the automatic feature would not be available due to market situations, lack of depth in the published quotation, or inappropriate pricing of the auto ex order, as follows:

(i) The NYSE's published quotation is non-firm (pursuant to Exchange Rule 60);

(ii) The NYSE's published quotation has been gapped (pursuant to the Exchange's usual procedures for such situations) for a brief period because of an influx of orders on one side of the market, and the Exchange's published quotation size is 100 shares at the bid and/or offer;

(iii) A better price exists in another Intermarket Trading System participating market center for a single-sided auto ex order;

(iv) The NYSE's published bid or offer is 100 shares (see Exchange Rule 1001(c)).<sup>6</sup>

(v) A transaction outside the Exchange's published quotation pursuant to Exchange Rule 127 is in the process of being completed, in which case the specialist should publish a 100-share bid and/or offer; or

(vi) Trading in the subject security has been halted.

Rule 1000 provides that an auto ex order that cannot be immediately executed for any of the above reasons shall be automatically entered for execution in the Exchange's auction market.

<sup>6</sup> The situations discussed in subparagraphs (ii) and (v) of proposed Rule 1000 provide examples of instances where the Exchange's published bid or offer would be 100 shares. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

#### Rule 1001

Rule 1001(a) provides that the contra side of an auto ex execution will be trading interest reflected in the Exchange's published quotation, consistent with the principles of priority and parity as codified in Exchange Rule 72.

Rule 1001(a) also provides that it shall be the specialist's responsibility, after receiving a report that an auto ex order has been executed, to assign the appropriate number of shares to each bidder or offeror, consistent with the principles of Exchange Rule 72, with a universal contra being reported as the contra to each auto ex execution. Rule 1001(a) also provides that the specialist shall take the contra side of an auto ex execution where the interest in the published quotation against which the auto ex order was executed is no longer available.

Rule 1001(b) provides that if the published bid or offer is not of sufficient depth to fill an auto ex order in its entirety, the unfilled balance of the order shall be displayed in the auction market.

Rule 1001(c) provides that if executions of auto ex orders have traded with all trading interest reflected in the Exchange's published bid or offer, the Exchange will disseminate a bid or offer at that price of 100 shares until the specialist requotes that market. Auto ex orders will not receive an automatic execution against any 100 share bid or offer, whether a default bid or offer or otherwise, but rather will be displayed in the auction market. Rule 1001(c) provides that the specialist shall be the contra party to any auction market interest seeking to trade against the 100 share default bid or offer.

Rule 1001(d) provides that the concept of precedence based on size, which is codified in Exchange Rule 72, shall not apply with respect to the contra side of an auto ex execution, with such contra side interest being assigned, as noted above, in accordance with the principles of priority and parity in Rule 72.

#### Rule 1002

Rule 1002 provides that auto ex orders may be entered on any day in a particular stock from the time the Exchange has published a bid or offer in that stock until 3:59 p.m., at which time the specialist is preparing the closing transaction in the security. If orders designated as auto ex are entered before a quote is published or after 3:59 p.m., the orders will be treated as limit orders in the auction market.

<sup>4</sup> To be exposed or entered in the "Exchange's auction market" means that the order would be treated like orders received through the SuperDOT system. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

<sup>5</sup> The Exchange has discussed with Commission staff the possibility of limiting the duration of the pilot to a one year period. The Exchange has not determined which stocks will be eligible for automatic execution under the pilot. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

**Rule 1003**

Rule 1003 provides that if a transaction is being completed in the auction market, and an execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to the auction market transaction shall be based on the last reported trade prior to the execution of the auto ex order.

For example, assume the Exchange's published quotation is 20 bid for 5000 shares, with 5000 shares offered at 20 and  $\frac{1}{16}$ . The last reported sale is 20 and  $\frac{1}{16}$ , which is a plus tick. A broker in the crowd bids 20 and  $\frac{1}{16}$  for 5000 shares, and another broker, representing a short sale order, agrees to trade at the 20 and  $\frac{1}{16}$  bid price. Before the trade at 20 and  $\frac{1}{16}$  is reported, an auto ex order to buy is automatically executed at the 20 and  $\frac{2}{16}$  published offer price, making the trade at 20 and  $\frac{1}{16}$  a minus tick, which would preclude execution of the order to sell short. Rule 1003 provides that in this instance, the short sale tick test would be based on the last reported sale of 20 and  $\frac{1}{16}$ , a plus tick, at the time the crowd brokers agreed to trade.<sup>7</sup>

**Rule 1004**

Rule 1004 provides that executions of auto ex orders shall elect stop orders<sup>8</sup> and percentage orders electable at the price of such executions. The rule also provides that stop orders so elected shall be executed pursuant to Exchange's auction market procedures, and shall not be guaranteed executions at the prices of subsequent auto ex executions.

**Rule 1005**

Rule 1005 provides that orders of greater than 1099 shares may not be broken down into smaller orders in order to receive an automatic execution. The rule also provides that auto ex orders for the same customer may be

entered at time intervals of no less than 30 seconds between entry of each such order.<sup>9</sup>

**Rule 476A**

The Exchange is also proposing to add Rules 1000 through 1005, which implement the Exchange's NYSE Direct+™ facility, to the List of Rules subject to imposition of fines under Rule 476A for minor violations of Exchange rules. Rule 476A provides that the Exchange may impose a fine, not to exceed \$5,000, or any member, member organization, allied member, approved person, or registered or non-registered employee of a member or member organization for a minor violation of certain specified Exchange rules.

The purpose for the proposed rule change to Rule 476A is to facilitate the Exchange's ability to induce compliance with all aspects of Rules 1000 through 1005. The Exchange believes failure to comply with the requirements of these rules and procedures should be addressed with an appropriate sanction and seeks Commission approval to add violations of these requirements to the Rule 476A List so as to have a broad range of regulatory responses available. The Exchange believes that this would more effectively encourage compliance by enabling a prompt, meaningful and heightened regulatory response (e.g., the issuance of a fine rather than a cautionary letter) to a minor violation of these rules.

The Exchange wishes to emphasize the importance it places upon compliance with Rules 1000 through 1005. While the Exchange, upon investigation, may determine that a violation of any of these rules is a minor violation of the type which is properly addressed by the procedures adopted under Rule 476A, in those instances where investigation reveals a more serious violation, the Exchange will provide an appropriate regulatory response. This includes the full disciplinary procedures available under Rule 476.

**Interpretive Issues**

The Exchange is also submitting herein for Commission approval the following interpretations of several NYSE rules, and will submit under separate cover a request for the appropriate relief from Commission

Rule 10a 1.<sup>10</sup> These matters concern situations pursuant to proposed Rule 1001(a)(iv) where the specialist may be required to take the contra side of an auto ex execution against the published quotation, even though the specialist's interest was not part of such quotation. For example, the published quotation may reflect the interest of a broker in the crowd whose interest is then executed in an auction market transaction. Before the published quotation can be updated to reflect the execution in the auction market, an auto ex order is executed against such quotation. In such instance, the specialist would be required to take the contra side of the auto ex execution. In other instances, the crowd broker might cancel his or her interest as reflected in the published quotation, but an auto ex order might be executed against such quotation before the published quotation can be updated. Again, in such instance, the specialist would be required to take the contra side of the auto ex execution.

*Exchange Rule 123A.40.* The specialist shall not be required to fill any stop orders elected by an auto ex execution at the price of the electing sale in any instance where the specialist was required by Rule 1001(a)(iv) to take the contra side of an auto ex execution.

*Exchange Rule 91.* As the specialist does not accept an auto ex order for execution or act as agent for such order, the transaction confirmation requirements of Rule 91 will not apply in any instance where the specialist is the contra party to an auto ex execution.

*Exchange Rule 104.* Exchange Rule 104 contains the specialist's affirmative and negative obligations, and restricts the specialists' ability to purchase stock on direct plus ticks, or sell stock on direct minus ticks. The Exchange is proposing that any instance in which the specialist is effecting such a direct tick transaction only because he or she has been required to assume the contra side of an auto ex execution as described above shall be deemed to be a "neutral" transaction for purposes of Rule 104, and shall be deemed not to be in violation of the rule. The Exchange believes that this interpretation is appropriate because the specialist is not setting the price, but is simply being required to trade at a price set by other market participants.<sup>11</sup>

<sup>7</sup> Commission staff notes that proposed Rule 1003 does not comply with Commission Rule 10a 1 under the Act or Exchange Rule 440B. Accordingly, the Exchange is submitting to the Commission under separate cover a request for appropriate relief from Commission Rule 10a 1. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, Sonia Patton, Attorney, Division, Commission, and Mike Trocchio, Attorney, Division, Commission (June 7, 2000).

<sup>8</sup> Although the text of proposed Rule 1004 refers only to stop orders, the Exchange has indicated that they also intend to apply the provisions of the rule to stop limit orders. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

<sup>9</sup> This 30 second time frame applies on a per stock basis (i.e., a single customer may enter multiple orders for different stocks, in intervals of less than 30 seconds). Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

<sup>10</sup> 17 CFR 240.10a 1.

<sup>11</sup> The Exchange has represented that these interpretations of Rules 123A.40, 91, and 104 will be included in the "Supplementary Material" section of the appropriate rules upon application by the Exchange for permanent approval of the pilot program. Phone call between Donald Siemer, Director, Market Surveillance, NYSE, Brian McNamara, Vice President, Market Surveillance,

**Commission Rule 10a 1.** Commission staff notes that Commission Rule 10a 1 and Exchange Rule 440B do not permit the execution of short sales on a minus or zero minus tick. The Exchange believes that the specialist should be exempted from Commission Rule 10a 1 when he or she is taking the contra side of an auto ex execution on a minus or zero minus tick because of Exchange Rule 1001(a)(iv), and has an existing short position, or would be creating a short position by virtue of such execution. In such instance, the specialist should be granted an exemption from Commission Rule 10a 1 because the specialist is required to trade at a price set by other market participants. Accordingly, the Exchange will be submitting under separate cover a request for the appropriate relief from Rule 10a 1 under these circumstances.

## 2. Statutory Basis

The Exchange believes the basis for this proposed rule change is the requirement under section 6(b)(5) of the Act<sup>12</sup> that an Exchange have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The proposed rule change also is designed to support the principles of Section 11A(a)(1) of the Act<sup>13</sup> in that it seeks to assure economically efficient execution of securities transactions, make it practicable for brokers to execute investors' orders in the best market, and provide an opportunity for investors' orders to be executed without the participation of a dealer.

With respect to the addition to the summary fine list under NYSE Rule 476A, the proposed rule change will also advance the objectives of section 6(b)(6) of the Act<sup>14</sup> by providing a procedure whereby member organizations can be "appropriately disciplined" in those instances when a rule violation is minor in nature, but a sanction more serious than a warning or cautionary letter is appropriate. In addition, the proposed rule change provides a fair procedure for imposing such sanctions, in accordance with the requirements of sections 6(b)(7)<sup>15</sup> and 6(d)(1)<sup>16</sup> of the Act.

NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (June 7, 2000).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> 15 U.S.C. 78k 1(a)(1).

<sup>14</sup> 15 U.S.C. 78f(b)(6).

<sup>15</sup> 15 U.S.C. 78f(b)(7).

<sup>16</sup> 15 U.S.C. 78f(d)(1).

## B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange has not solicited or received written comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

A. By order approve the proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW, Washington, DC 20549 0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to the File No. SR NYSE 00 18 and should be submitted by July 6, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00 15127 Filed 6 14 00; 8:45 am]

BILLING CODE 8010-01-M

## DEPARTMENT OF STATE

[Public Notice 3334]

### Bureau of Educational and Cultural Affairs: Program Title: Israel-Arab Peace Partners Program; Request for Proposals

**SUMMARY:** The Office of Citizen Exchanges of the Bureau of Educational and Cultural Affairs of the United States Department of State announces an open competition for grants under the Israel-Arab Peace Partners Program. U.S. public and private non-profit organizations meeting the provisions described in IRS regulation 26 CFR 1.501(c) may submit proposals to develop and implement exchange programs involving participants from both Israel and one or more Arab countries/entities in the Middle East or North Africa. Four grant awards are anticipated, as outlined below.

### Program Information

#### Overview

The Office of Citizen Exchanges of the Bureau of Educational and Cultural Affairs, U.S. Department of State, consults with and supports American public and private nonprofit organizations in developing and implementing multi-phased, often multi-year, exchanges of professionals, academics, youth leaders, public policy advocates, etc. These exchanges are focused on issues crucial to both the United States and the foreign countries involved, they represent focused, substantive, and cooperative interaction among counterparts, and they entail both theoretical and experiential learning for all participants. A primary goal is the development of sustained, international institutional and individual linkages. In addition to providing a context for professional development and cooperative, international problem-solving, these projects are intended to introduce participants to one another's political, social, and economic structures. Desirable components of an exchange may be local citizen involvement and activities that orient foreign participants to American society and culture.

<sup>17</sup> 17 CFR 200.30 3(a)(12).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the File No. SR-NASD-99-46 and should be submitted by January 25, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

Johnathan G. Katz,  
Secretary.

[FR Doc. 01-154 Filed 1-3-01; 8:45 am]

BILLING CODE 8010-10-M

#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43767; File No. SR-NYSE-00-18]

#### Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Accelerating Approval of Amendment Nos. 1 and 2, on a Pilot Basis Ending on December 21, 2001, Relating to NYSE Direct+, the Exchange's Automatic Execution Facility for Certain Limit Orders of 1099 Shares or Less

December 22, 2000.

#### I. Introduction

On May 1, 2000, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4

thereunder,<sup>2</sup> a proposed rule change implementing NYSE Direct+, an automatic execution facility for certain limit orders of 1099 shares or less. The proposed rule change was published for public comment in the *Federal Register* on June 15, 2000.<sup>3</sup> The Commission received one comment letter regarding the proposed rule change.<sup>4</sup> The Exchange submitted Amendment Nos. 1 and 2 to the proposed rule change on August 21, 2000<sup>5</sup> and December 21, 2000,<sup>6</sup> respectively. This order approves the proposed rule change on a pilot basis ending on December 21, 2001 and grants accelerated approval to Amendment Nos. 1 and 2. The Commission is also soliciting comment on Amendment Nos. 1 and 2 to the proposed rule change.

#### II. Description of the Proposed Rule Change

The proposed rule change establishes a new trading platform, NYSE Direct+, for the automatic execution of certain

limit orders of 1099 shares or less ("auto ex" orders) against trading interest reflected in the Exchange's published quotation. Limit orders priced at or above the Exchange's published offer price (in the case of an auto ex order to buy), and limit orders priced at or below the Exchange's published bid price (in the case of an auto ex order to sell) are eligible for automatic execution via NYSE Direct+. The contra side of the auto ex order would be the trading interest reflected in the Exchange's bid or offer, in accordance with the Exchange's auction market principles of priority and parity codified in Exchange Rule 72. Auto ex orders would receive automatic executions without being exposed to the auction market.<sup>7</sup> However, if the automatic execution feature is not available,<sup>8</sup> the auto ex order would be entered for execution in the Exchange's auction market. Auto ex transactions would be identified on the Consolidated Tape with a unique identifier, and the Exchange's published bid or offer would be automatically decremented to the extent of the size of the auto ex order to reflect the automatic execution.

It would not be mandatory that all eligible limit orders of 1099 shares be entered as auto ex orders NYSE Direct+. Member organizations (or their customers if enabled by the member organization) can choose to use NYSE Direct+ when the speed and certainty of an execution at the Exchange's published bid or offer price is in the customer's best interest. If a customer's interest would best be served by affording the customer's order the opportunity for price improvement, the member (or customer) may enter a limit or market order by means of the SuperDOT system for representation in the auction market, rather than an auto ex order.

The Exchange's proposal would be implemented in proposed Rules 1000 through 1005.<sup>9</sup> Rule 1000 species the types of orders eligible for entry as auto ex orders. In addition, the Rule lists six instances where the automatic execution feature would not be available due to, for example, particular market situations, lack of depth in the published quotation, or inappropriate

<sup>7</sup> To be exposed or entered in the Exchange's auction market means that the order would be treated like orders received from the SuperDOT system. See Amendment No. 1, *supra* note 5.

<sup>8</sup> See proposed Rule 1000.

<sup>9</sup> The Exchange file a separate proposed rule change to implement Rule 1006, which provides for the automatic execution of coupled orders of 1099 shares or less at a price that is at or within the Exchange's published quotation. Securities Exchange Act Release No. 43110 (August 2, 2000), 65 FR 48776 (August 9, 2000).

<sup>25</sup> 17 CFR 2000.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

pricing of the auto ex order.<sup>10</sup> Rule 1001 sets forth the execution parameters for orders entered in NYSe Direct+, including the contra side interest reflected in the Exchange's published quotation. Rule 1001(a)(iv) provides that the specialist shall be the contra party to any automatic execution of an auto ex order where interest reflected in the published quotation against which the auto ex order was executed is no longer available.<sup>11</sup> Rule 1002 addresses when the system is available for automatic execution each trading day. Rule 1003 governs the application of tick tests to auction market transactions when an auto ex order is reported at a different price after an auction market transaction has been agreed upon, but before the market transaction is reported.<sup>12</sup> This rule provides that any tick test applicable to the auction market transaction will be based on the last reported auction market sale.<sup>13</sup> Rule 1004 provides that auto ex orders may elect stop orders and percentage orders electable at the price of such executions.<sup>14</sup> Rule 1005 prohibits the entry of auto ex orders in intervals of less than 30 seconds on a per stock basis.<sup>15</sup> The Exchange also proposes to amend Exchange Rule 13 to add the definition of auto ex orders and to amend Exchange Rule 476A to add Rules 1000-1005 to the list of rules subject to summary fine procedures.

#### Interpretive Issues

The Exchange also requested that the Commission approve interpretations of Exchange Rules 123A.40, 91, and 104. These interpretations arise in situations

under proposed Rule 1001(a)(iv) where the specialist is required to take the contra side of an auto ex execution against the published quotation, as discussed above. In short, the interpretations provided by the Exchange state that when the specialist is required to take the contra side of an auto ex order pursuant to Rule 1001(a)(iv), the specialist may not be required to fill any stop orders elected by an auto ex execution at the price of the electing sale pursuant to Rule 123A.40; that the transaction confirmation requirements of Rule 91 do not apply; and that in any instance in which the specialist is effecting a direct tick transactions only because he or she has been required to assume the contra side of an auto ex execution, the transaction shall be deemed a "neutral" transaction for purposes of Exchange Rule 104.

#### Commission Rule 10a-1.

As stated in the notice for this proposed rule change, Commission Rule 10a-1 and Exchange Rule 440B do not permit short sales to be effected on a minus or zero minus tick. However, the Exchange proposed that under Rule 1001(a)(iv), the specialist should be permitted to sell short on a minus or zero minus tick when he or she takes the contra side of an auto ex execution because either: (1) the published quotation reflects interest that has received an execution, but the quotation has not been updated to reflect this fact; or (2) the published quotation reflects this fact. The Exchange believes that the specialist should be exempted from Commission Rule 10a-1 under these circumstances because the specialist is required to trade at a price set by other market participants.

In addition, as also set forth in the notice for this proposed rule change, the Exchange has requested an exemption from Commission Rule 10a-1 for Rule 1003. Rule 1003 provides that if a transaction has been agreed upon<sup>16</sup> in the auction market, and an execution involving auto ex orders is reported at a different price before the auction market transaction is reported, any tick test applicable to the auction market transaction will be based on the last reported trade prior to the reporting of the auto ex transaction.

#### III. Comments

The Commission received one comment letter from the Investment Company Institute ("ICI").<sup>17</sup> The ICI questioned the purpose and necessity of

the 30-second delay between entry of auto ex orders. Specifically, the ICI stated that the delay would "defeat the purpose of providing investors with a facility to automatically execute limit orders without intervention of a dealer." The ICI also strongly supported the idea of increasing the maximum number of shares that can be entered into NYSe Direct+ for automatic execution, and recommended that the pilot program include "securities representing a substantial portion of the NYSE market, e.g., the top 100 NYSE listed securities, with the remainder chosen from quintiles of NYSE securities." In response to the ICI's comments on these particular issues, the Exchange noted that the proposed parameters are appropriate for the initial launch of the pilot program.<sup>18</sup> The Exchange also noted that a primary purpose of the pilot program is to allow the Exchange, NYSe Direct+ participants, and the Commission to examine the operation of the system on a controlled basis. Thus, the Exchange believes that the parameters regarding each of the issues noted above are appropriate at this pilot stage.

The ICI also questioned the prohibition on breaking up orders for entry into NYSe Direct+. The ICI noted that it is unclear what type of "order" the proposed rules are referring to, and requested clarification whether a broker for an institution asked to "work" a large order could utilize NYSe Direct+ to execute all or part of the institution's order. In response, the Exchange has deleted this prohibition from the proposed rule change although it has retained the 30-second interval between orders on a per share basis.<sup>19</sup> The Exchange noted, moreover, that a broker "working" an institutional client's order by simply breaking the order up for entry into NYSe Direct+ may not be executing the order consistent with the broker's duty of best execution.<sup>20</sup>

Finally, the ICI recommended that strict price/time priority be applied to the execution of NYSe Direct+ orders, rather than executed in accordance with Exchange Rule 72, which provides for executions pursuant to principles of priority and precedence. Specifically, the ICI noted that applying strict price/time priority would "rectify, for example, a situation where a market

<sup>10</sup> The Exchange notes that Rules 1000(ii) and (v) are, in effect, examples of proposed Rule 1000(iv). See Amendment No. 1, *supra* note 5.

<sup>11</sup> For purposes of Rule 1001(a)(iv), the only circumstances under which interest reflected in the published quotation "is no longer available" are either: (1) The published quotation reflects interest that has received an execution, but the quotation has not been updated to reflect this fact; or (2) the published quotation reflects interest that has been cancelled, but the quotation has not been updated to reflect this fact. See Letter regarding NYSe Direct+ (December 21, 2000) ("Exemption Letter"). Rule 1001(a)(iv) is the subject of an exemption issued by the Commission to the Exchange granting certain relief from Commission Rule 10a-1. *Id.*

<sup>12</sup> See Amendment No. 2, *supra* note 6. Rule 1003 is also the subject of an exemption issued by the Commission to the Exchange granting certain relief from Commission Rule 10a-1. See Exemption Letter.

<sup>13</sup> See Amendment No. 1, *supra* note 5.

<sup>14</sup> Amendment No. 1 clarifies that executions of auto ex order shall elect stop limit orders as well as stop orders and percentage orders electable at the price of such executions. See Amendment No. 1, *supra* note 5.

<sup>15</sup> Amendment No. 1 clarifies that the prohibition on entering orders within 30-seconds applies on a per stock basis. See Amendment No. 1, *supra* note 5.

<sup>16</sup> See Amendment No. 2, *supra* note 6.

<sup>17</sup> See *supra* note 4.

<sup>18</sup> The Exchange responded to these concerns in a phone call between Brian McNamara, Vice President, Market Surveillance, NYSE, Donald Sliemer, Director, Market Surveillance, NYSE, Rebekah Liu, Special Counsel, Division, Commission, and Sonia Patton, Attorney, Division, Commission (August 31, 2000).

<sup>19</sup> See Amendment No. 2, *supra* note 6.

<sup>20</sup> *Id.*

participant would be able to participate on the contra side of an automatic execution even though another participant may have placed an order in the NYSE earlier in time." In response, the Exchange stated that it believes that all orders, including orders entered in NYSe Direct+, executed on the Exchange should be subject to the same execution principles of priority and precedence, as set forth in Exchange Rule 72.<sup>21</sup>

#### IV. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change is consistent with section 6(b)(5) of the Act<sup>22</sup> which requires an Exchange to have rules that are designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The proposed rule change is also consistent with section 11A(a)(1) of the Act<sup>23</sup> which states that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically efficient execution of securities transactions and the practicability of brokers executing investor orders in the best market, and to provide an opportunity for investors' orders to be executed without the participation of a dealer.<sup>24</sup>

The Commission finds that by allowing the automatic execution of limit orders against the interest reflected in the Exchange's published quotation, NYSe Direct+ helps to perfect the mechanism of a free and open market by providing a trading venue for customers who value the speed and certainty of automatic execution more than the opportunity for price improvement offered by the Exchange's agency-auction trading floor. NYSe Direct+ also facilitates securities transactions to the benefit of investors by allowing direct access by a member organization, or its customer, to the trading interest reflected in the Exchange's published quotation. The Commission notes that this direct access, in turn, may attract

more order flow and increase the depth and liquidity of the Exchange's market to the benefit of investors and the public interest.

The Commission further finds that NYSe Direct+ provides an opportunity for a customer's order to be executed with limited broker participation, consistent with the goals of the Act. Although a member firm must still act as the gateway for any customer wishing to utilize NYSe Direct+, the direct and automatic matching of customer limit orders against the interest reflected in the Exchange's quotation minimizes the involvement of the member firm. The Commission also believes that NYSe Direct+ may have the potential to lower transaction costs, another potential benefit to Exchange customers.

The Commission also finds that operation of NYSe Direct+ is consistent with the protection of investors and the public interest and should help to maintain a fair and orderly market. The proposed rules specifically outline the terms under which a customer's order would be handled by the NYSe Direct+ system, and they provide for the handling of those orders if there is no contra-side interest in the Exchange's published quotation.

The Commission finds that the Exchange has addressed the most significant concerns raised by the ICI Letter.<sup>25</sup> The Commission agrees that the proposed parameters are appropriate for the initial launch of the pilot program. A primary purpose of the pilot program is to allow the Exchange, NYSe Direct+ participants, and the Commission to examine the operation of the system on a controlled basis. Thus, the Commission finds that the proposed parameters by the Exchange for NYSe Direct+ are appropriate at this pilot stage. The Commission notes that it will expect the Exchange to choose stocks eligible for the pilot program based on a number of appropriate criteria, including volume, trading characteristics and floor location.<sup>26</sup>

With respect to the ICI's request for further clarification on the prohibition of breaking up orders of greater than 1099 shares into smaller amounts, the Commission notes that the Exchange amended the proposed rule change to delete the explicit prohibition against breaking up orders for the purpose of receiving an automatic execution. The Commission believes that amended Rule 1005 provides an appropriate mechanism to discourage brokers from breaking up large orders solely to obtain

an automatic execution, while allowing brokers acting on behalf of institutions to use NYSe Direct+ to "work" large orders, consistent with their duty of best execution. The Commission also finds that for purposes of consistency and uniformity, all bids or offers executed on the Exchange should be subject to the execution principles set forth in Exchange Rule 72.

#### Interpretative Issues

The Commission also approves the Exchange's interpretation of Exchange Rules 123A.40, 91, and 104.<sup>27</sup> These interpretations all concern a situation where, pursuant to proposed Rule 1001(a)(iv), the specialist is required to take the contra side of an auto ex execution against the published quotation, even though the specialist's interest was not part of the published quotation. In addition, the Commission has granted the Exchange exemptive relief from Commission Rule 10a-1 for purposes of proposed Rule 1001(a)(iv).<sup>28</sup> The Commission therefore finds the requested interpretations are appropriate and necessary for the proper functioning of the NYSe Direct+ trading platform.

#### Commission Rule 10a-1

Commission Rule 10a-1 and Exchange Rule 440B did not permit short sales to be effected on a minus or zero minus tick. As discussed above, the Exchange has requested an exemption from Rule 10a-1 when a specialist is required to take the contra side of an auto ex execution pursuant to Exchange Rule 1001(a)(iv). In addition, the Exchange has requested an exemption to

<sup>27</sup> The Interpretations of these Rules are as follows:

*Exchange Rule 123A.40.* The specialist shall not be required to fill any stop orders elected by an auto ex execution at the price of the electing sale in any instance where the specialist was required by Rule 1001(a)(iv) to take the contra side of an auto ex execution.

*Exchange Rule 91.* As the specialist does not accept an auto ex order for execution or act as agent for such order, the transaction confirmation requirements of Rule 91 will not apply in any instance where the specialist is the contra party to an auto ex execution.

*Exchange Rule 104.* Exchange Rule 104 contains the specialist's affirmative and negative obligations, and restricts the specialists' ability to purchase stock on direct plus ticks, and sell stock on direct minus ticks. The Exchange is proposing that any instance in which the specialist is effecting such a direct tick transaction only because he or she has been required to assume the contra side of an auto ex execution as described above shall be deemed to be a "neutral" transaction for purposes of Rule 104, and shall be deemed not to be in violation of the rule. The Exchange believes that this interpretation is appropriate because the specialist is not setting the price, but is simply being required to trade at a price set by other market participants.

<sup>28</sup> See Exemption Letter.

<sup>21</sup> *Id.*

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> 15 U.S.C. 78k-1(a)(1).

<sup>24</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>25</sup> See *supra* Section II and note 4.

<sup>26</sup> This is consistent with the Exchange's representations in Amendment No. 1, *supra* note 5.

permit floor brokers to effect short sales in the auction market based upon the last reported transaction at the time of the agreement to the auction market trade, and irrespective of auto ex trades that are reported while the transaction is being completed, as contemplated by Rule 1003. In a letter dated December 21, 2000, the Commission granted to the Exchange certain exemptive relief from Commission Rule 10a-1 regarding these Exchange rules for the duration of the pilot, subject to the conditions described in the letter.<sup>29</sup> Consequently, the Commission finds that in light of the relief granted from Rule 10a-1, Rule 10a-1 does not prohibit implementation of NYSE Direct+ as discussed in this order, during the pilot program. If the Exchange decides to continue the program, the Exchange would be required to submit a proposed rule change extending, or requesting permanent approval of, the pilot, and another request for relief from Commission Rule 10a-1.

#### *Accelerated Approval for Amendment No. 1*

The Commission finds good cause for accelerating approval of Amendments Nos. 1 and 2 to the proposed rule change prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that these Amendments provide useful clarifications to the proposed rules. Accordingly, the Commission finds that good cause exists, consistent with sections 6(b)(5) of the Act,<sup>30</sup> and section

19(b) of the Act<sup>31</sup> to accelerate approval of Amendments Nos. 1 and 2 to the proposed rule change.

#### **V. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning Amendments Nos. 1 and 2, including whether the amendments are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commissions and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NYSE. All submissions should refer to the File No. SR-NYSE-00-18 and should be submitted by January 25, 2001.

#### **VI. Conclusion**

*It Is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>32</sup> that the proposed rule change (SR-NYSE-00-18), as amended, is approved on a pilot basis until December 21, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>33</sup>

**Jonathan G. Katz,**  
*Secretary.*

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#### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-43771; File No. SR-NYSE-00-33]

#### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc., Amending NYSE Rule 15A Relating to the Intermarket Trading System**

December 22, 2000.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 18, 2000, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. On November 30, 2000, the Exchange filed an amendment to the proposed rule change.<sup>3</sup> As amended, the proposal is effective upon filing with the Commission, pursuant to section 19(b)(3)(A) of the Act,<sup>4</sup> and Rule 19b-4(f)(6) thereunder.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend NYSE Rule 15A with respect to the definition of "ITS/CAES Market Maker." Below is the text of the proposed rule change. Additions are italicized and deletions are in brackets. NYSE Rule 15A(a)(6)

"ITS/CAES Market Maker", as that term is used in the Rule, means a NASD member that is registered as a market maker with the NASD for the purposes of the Applications with respect to one or more specified *System securities* ["ITS/CAES securities" as more fully described in the ITS Plan].

#### **II. Self-Regulatory Organization's Statement of the Purposes of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The

<sup>29</sup> See Exemption Letter. The exemption granted with respect to proposed rule 1001(a)(iv) is limited to situations where the specialist is required to take the contra side of an auto ex execution against the published quotation, even though the specialist's interest was not part of the published quotation, because: (1) The published quotation reflects interest that has received an execution, but the quotation has not been updated to reflect this fact; or (2) the published quotation reflects interest that had been cancelled, but the quotation has not been updated to reflect this fact. The no-action relief with respect to proposed Rule 1003 is subject to certain limitations. First, when an auto ex trade is reported between the time that the auction market short sale is agreed upon and when it is reported, and the auto ex trade report is at a price that would result in the auction market trade being reported as a minus or zero-minus tick, the auction market short sale must be presented to an NYSE floor official. In addition, the NYSE floor official must: (a) find that the short sale was presented for reporting immediately after agreement to the trade; (b) find that the short sale was priced in compliance with Rule 10a-1 at the time that the floor brokers agreed to the trade; (c) find that the short sale price is not lower than the best bid displayed in the auction market at the time the transaction is reported; and (d) direct that the trade be reported as a "sold sale." Finally, the NYSE must keep records of all floor brokers' transactions relying upon this exemption, and present this information upon request to the Division.

<sup>30</sup> 15 U.S.C. 78f(b)(5).

<sup>31</sup> 15 U.S.C. 78s(b).

<sup>32</sup> 15 U.S.C. 78s(b)(2).

<sup>33</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See November 30, 2000 letter from James E. Buck, Corporate Secretary, NYSE, to Joseph P. Morra, Special Counsel, Division of Market Regulation, Commission ("Amendment No. 1"). In Amendment No. 1, the NYSE asked the Commission to consider the proposal pursuant to Section 19(b)(3)(A) of Act and Rule 19b-4(f)(6) thereunder. 15 U.S.C. 78s(b)(3)(A), 17 CFR 240.19b-4(f)(6). The Commission has agreed to accept the original proposal as satisfying the 5-day pre-filing requirement pursuant to Rule 19b-4(f)(6). 17 CFR 240.19b-4(f)(6).

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6). For purposes of calculating the 60-day abrogation period, the Commission considers the period to begin as of the date the Exchange filed Amendment No. 1, November 30, 2000.